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**The Tax Adjustment Act of 1945**

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**Some Tax Effects of V-Day**

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*Accountants and Auditors*

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## The Tax Adjustment Act of 1945

By W. H. DAVIDSON

(New York Office)

The Tax Adjustment Act of 1945, enacted July 31, 1945, was designed to improve the cash position of business during the period of re-conversion and readjustment to peacetime production and to aid small corporations by increasing the excess profits tax exemption. Tax rates remain unchanged. There follows a brief digest of most of the new provisions.

### CHANGES REGARDING POST-WAR REFUND OF EXCESS PROFITS TAX

For taxable years beginning after December 31, 1943 the 10 per cent post-war refund is eliminated. In lieu thereof a direct credit of 10 per cent is allowed against the excess profits tax. The excess profits tax for computing the 10 per cent credit is before any credit for foreign taxes or any adjustment for inconsistent position.

The law does not state how the credit operates when the tax has not been paid in full. The report of the House Ways and Means Committee indicates that where a corporation has filed an excess profits tax return for the calendar year 1944, one-half of the 10 per cent credit may be deducted from the third instalment due September

15, 1945 and presumably the other half will be deductible from the instalment due December 15, 1945. Since the 10 per cent is now a direct credit against the tax it would seem that three-quarters of the credit should be allowed as a deduction from the September 15 payment. However, in a press release the Commissioner has stated that the 10 per cent credit must be prorated equally over the remaining instalments, as suggested by the Ways and Means Committee. The press release states that in the case of a taxable year beginning prior to January 1, 1944 the full 10 per cent credit may be taken against the last instalment, and in the case of returns filed hereafter the credit should be taken on the face of the return (Line 21, Form 1121, if a 1944 form is used).

No interest is allowable on any overpayment of tax attributable to the 10 per cent credit for taxable years ending before December 31, 1945 unless the credit is claimed in the taxpayer's return. If the taxpayer has filed its return and the due date of the return including extensions has passed, no interest can be secured by filing an amended return according to the Ways and Means Committee Report.

In the case of a corporation which has paid in full the excess profits tax due for a year beginning on or after January 1, 1944, the Treasury will refund the 10 per cent credit on its own initiative, according to the press release. The release also provides that a corporation paying a tax deficiency for a taxable year which began before January 1, 1944 may reduce the payment by the 10 per cent credit. No interest for the period after December 31, 1945 will be collected by the Treasury on the portion of the tax or deficiency equal to such 10 per cent.

In the case of taxable years beginning before January 1, 1944 post-war bonds will be payable at the option of the owner on or after January 1, 1946. No post-war bonds will be issued for such years unless the tax or deficiency in tax was paid before July 1, 1945. Any 10 per cent credit remaining at January 1, 1946 for which bonds have not been issued will be paid to the taxpayer in cash.

#### INCREASE IN EXCESS PROFITS TAX SPECIFIC EXEMPTION

For taxable years beginning after December 31, 1945 the specific excess profits tax exemption is increased from \$10,000 to \$25,000. In the case of fiscal years beginning in 1945 and ending in 1946 the exemption is the sum of (A) that proportion of \$10,000 which the number of days in the taxable year

prior to January 1, 1946 bears to the number of days in the taxable year and (B) that proportion of \$25,000 which the number of days in the taxable year after December 31, 1945 bears to the number of days in the taxable year.

#### EXTENSIONS FOR PAYMENT OF TAXES BY CORPORATIONS EXPECTING CARRY-BACKS

The new law contains provisions to give relief to corporations expecting to have net operating loss carry-backs or unused excess profits credit carry-backs from taxable years which have not yet ended. If a corporation expects to have a net operating loss carry-back or unused excess profits credit carry-back from any taxable year ending on or after September 30, 1945 it may postpone payment of part of the taxes for the taxable year *immediately preceding* if it files a statement with the Collector at such time as will be prescribed by regulation.

The statement to be filed with the Collector must contain among other things the estimated amount of the carry-back, the reasons for expecting the carry-back, and the amount of the reduction in prior year's taxes attributable to the expected carry-back. The taxes affected include income taxes, declared value excess-profits taxes and excess profits taxes.

Generally, if the above statement is filed, there may be postponed a

portion of the preceding year's tax equal to the reduction in tax for all years that would result from the carry-back from the taxable year. For example, a net operating loss for the year 1945 could be carried back to 1943 and cause an unused excess profits credit to be carried back to 1941. In such case, there could be postponed a portion of the unpaid 1944 tax equal to the overpayments for the years 1941 to 1944, inclusive, that might result from the carry-back of the 1945 net operating loss.

The total tax for the preceding year is to be reduced by the amount postponed, and the balance is prorated in four equal instalments corresponding to the statutory payment dates. For example, assume a corporation's returns for 1944 show taxes of \$100,000, of which \$50,000 has been paid in the first two instalments. Because of expected carry-backs from 1945 it claims a postponement of \$20,000 of the 1944 tax, leaving \$80,000, of which \$50,000 has been paid. The corporation will then pay \$10,000 on September 15, 1945 and \$20,000 on December 15, 1945.

The extension of the time for payment of the preceding year's tax expires on the last day of the month in which the return is due for the taxable year of the expected net operating loss or unused excess profits credit (including any extension granted for filing such return). However, if before such

expiration date the corporation files an application for tentative carry-back adjustment (discussed later) the extension of time for payment runs until the Commissioner mails a notice by registered mail that such application is allowed or disallowed in whole or in part.

A taxpayer may file a revised statement of expected carry-back and if it is for a lesser amount the extension for payment of the difference terminates. The Commissioner may terminate the extension with respect to any amount which upon examination he believes is in a material respect erroneous or unreasonable.

#### TENTATIVE CARRY-BACK ADJUSTMENTS

The foregoing discussion dealt with corporations which *expect* to have a net operating loss or an unused excess profits credit. The following discussion deals with the situation after such a loss or unused credit has arisen. Any taxpayer, whether or not a corporation, which has a net operating loss or an unused excess profits credit for a taxable year ending on or after September 30, 1945 may file an application for a tentative carry-back adjustment of the taxes for prior taxable years. The application must be filed on or after the date of filing the return for the taxable year in which the loss or unused credit arises and within twelve months from the end of such taxable year. The appli-

cation must show among other things the increase or decrease in each tax for each prior year affected by the carry-back.

The Commissioner is required to make a limited examination of such application within ninety days from the date it is filed, or from the due date of the return (including extensions granted) for the taxable year in which the loss or unused credit arises, whichever is later. The Commissioner must determine as a result of such limited examination the increase or decrease in each tax for each prior year resulting from the carry-back, but the Commissioner may disallow any application which he finds contains errors of computation which he deems cannot be corrected by him within such ninety-day period or material omissions.

Any net overpayment for prior years which the Commissioner determines results from such carry-back is applied first against any unpaid tax for the year preceding the year of the loss or unused credit, and the balance will within the ninety-day period be credited against any tax then due from the taxpayer or be refunded to the taxpayer. If the Commissioner later finds that the credit or refund was excessive he may, if he so chooses, assess the difference immediately as in the case of a mathematical error on the face of the return without allowing an appeal to the Tax Court. However, the Ways and

Means Committee report states that it is contemplated that the Commissioner will ordinarily determine a deficiency in the usual manner and allow an appeal to the Tax Court.

#### PENALTY FOR SUBSTANTIAL OVER-STATEMENT OF EXPECTED CARRY-BACKS

If a taxpayer postpones the payment of a tax because of an *expected* carry-back there is a penalty of 5 per cent if the amount postponed is materially excessive. The 5 per cent is applied to the excess of the postponed tax over 125 per cent of the net amount of overpayment determined as a result of an application for a tentative carry-back adjustment. The penalty applies only to the portion of the tax which is not paid by the end of the taxable year in which the extension is made and can therefor be avoided by paying the tax in full before the end of the year. The penalty does not apply if the taxpayer establishes to the satisfaction of the Commissioner that as of the end of the taxable year in which the extension was made there was reasonable cause to expect the claimed carry-back.

#### INTEREST ON POSTPONED TAXES

When a corporation postpones payment of a tax because it expects to have a carry-back upon the taxable year the postponed tax bears interest. The interest runs



from the dates on which payments would have been required if there had been no extension and the taxpayer had elected to pay the tax in four equal instalments. If the corporation later files an application for a tentative carry-back adjustment the interest charge is at the rate of three per cent per annum to the date the Commissioner credits the overpayments against the postponed tax. The interest rate is six per cent per annum to the date of payment on any postponed tax that is not satisfied by a credit pursuant to a tentative carry-back adjustment.

#### TENTATIVE ADJUSTMENTS WITH RESPECT TO AMORTIZATION DEDUCTIONS

Under the Code prior to the new amendments if a taxpayer secured a certificate to the effect that an emergency facility ceased to be necessary in the interest of national defense (non-necessity certificate) the taxpayer could elect to shorten the amortization period and recompute the taxes for prior years. The amortization period could also be shortened if the President proclaimed the ending of the emergency. Under the regulations the election must be made within ninety days of the date of the non-necessity certificate or the proclamation of the President.

In order to speed the refunds attributable to shortening of the amortization period the new Act

contains a provision very similar to the provision regarding tentative carry-back adjustments. Any taxpayer who has filed an election to shorten the amortization period may file an application for a tentative adjustment of the taxes of prior years. The application must be filed within ninety days from the date of filing the election to shorten the amortization period or within ninety days from the date of enactment of the new Act, whichever is later.

The Commissioner is required within ninety days from filing of the application to make a limited examination of the application and credit or refund the tax overpayments as in the case of tentative carry-back claims.

#### UNPAID TAXES WHEN REFUNDS ARE PENDING

The Commissioner's press release states that if a taxpayer has any tax payments coming due while an application is pending for a 90-day refund on account of a carry-back or amortization allowance he may apply to the Collector for an extension of time so as to avoid making any payments which would thereafter have to be refunded.

#### SPECIAL PERIOD OF LIMITATION REGARDING CARRY-BACKS

A claim for refund attributable to a carry-back may be filed within the period of limitation applicable

*(Continued on page 18)*

## Some Tax Effects of V-Day

BY JAMES J. MAHON, JR.

(Philadelphia Office)

To most companies engaged in war work, V-Day means "contract termination." In an article entitled "Tax Effects of Contract Terminations," which appeared in the May issue of the JOURNAL, the writer discussed some of the tax features involved in negotiated settlements, the recomputation under certain conditions of deductions for amortization of emergency facilities, etc. With terminations in many billions of dollars already announced by the armed services following the surrender of Japan, the discussion in the aforementioned article becomes more pertinent than ever before.

The ending of the war has given rise to certain other tax problems aside from those inherent in contract termination, as, for example, those relating to investments in enemy countries or enemy-controlled countries, the replacement of inventories on last-in, first-out basis, etc., and it is these problems which are discussed in the following paragraphs.

### War Loss Recoveries

Section 127, as added to the Internal Revenue Code by the 1942 Revenue Act, provides for (1) the determination and deduction of war losses, and (2) the effect upon in-

come (or basis of property) of any subsequent recoveries of either money or property on account of such losses. In the early stages of the United States' participation in the war American taxpayers with foreign holdings (of either property or other investments) were primarily interested in determining the amounts of war losses suffered, the resultant tax deduction therefor, and the proper year for such deduction. Briefly the types of property for which war losses can be claimed under Section 127 are as follows:

1. Physical property located in any enemy country or enemy-controlled country on the date war was declared thereupon by the United States. (Section 127 (a) (2).)
2. Intangible property located in any enemy country or enemy-controlled country on the date war was declared thereupon by the United States if such intangible property is of a type subject to sequestration or confiscation by the enemy. (Section 127 (a) (2).)
3. Physical property not located in enemy countries but which was destroyed or seized in military operations on or after December 7, 1941. (Section 127 (a) (1).)
4. Intangible property (i.e., accounts receivable from, or stocks, bonds, or other securities of, a corporation or obligation of an individual) that becomes worthless by reason of the destruction or seizure of underlying physical assets referred to in "3" above. (Section 127 (a) (3).)

In determining the amount of the war loss, the adjusted basis of the



property seized or destroyed may be reduced by the amount of any obligations or liabilities of the taxpayer with respect to such property, which obligation may or may not have been satisfied from the property. For instance, a plant located in Paris having an adjusted basis of \$500,000 may be encumbered by a mortgage of, say, \$200,000, which is held by French interests. It may have been satisfied from the property, and the taxpayer therefore has the option of reducing the loss of \$500,000 on the property to \$300,000, the "net" loss. (Section 127 (b) (2).)

#### *Effect of War Loss Recoveries Upon Gross Income*

The amount of any money and the fair market value of any property recovered with reference to property or an interest in property previously considered as seized or destroyed in a prior taxable year under the provisions of Section 127 (a) (hereinbefore discussed) constitutes taxable income to the following extent (Section 127 (c)):

1. To the extent that the prior years' losses did not result in a tax benefit, the amounts recovered are not taxable.
2. To the extent that the prior years' losses *did* result in a tax benefit, the amounts recovered are taxable as ordinary income.
3. To the extent that the amounts recovered exceed the total of the above classes, they are taxable as a gain upon the involuntary conversion of property subject to the limitation of Section 117 (j).

The determination of the amount of prior years' losses that resulted in a "tax benefit" is defined in Sec. 29.127 (f)-1, Reg. 111. It is there provided, in effect, that that part of a deduction for a war loss which if disallowed would result in an increase in income taxes for any year (either through the use of a net operating loss deduction or otherwise) results in a tax benefit.

An excellent example of the operation of the war loss recoveries provisions of the Code, which appears in *Montgomery's Federal Taxes on Corporations, 1944-1945*, is here reproduced:

Assume that the taxpayer lost a plant located near Paris, such loss being deemed to have occurred in December, 1941, as northern France was occupied in 1940. The amount of the war loss deductible in 1941 is computed as follows:

Adjusted basis of property (cost less depreciation) (Section 127 (b) (1))	\$500,000
Less: Mortgage on the property held by French interests, which may or may not have been satisfied out of the property (Section 127 (b) (2))	200,000
Amount of war loss deductible in 1941	<u>\$300,000</u>

The taxpayer's net income for 1941 before deducting the war loss was say, \$250,000, and let us say that the remaining \$50,000 of the loss did not result in a reduction of any tax

of the taxpayer for 1941 or any subsequent year. After the war the taxpayer recovers the plant undamaged, and at a time when demand for its product in the European market causes the property to have a fair market value of \$1,000,000. The taxpayer finds that the mortgage was not satisfied. The recovery of \$1,000,000 will then be taxed as follows:

<i>Portion of Recovery</i>	<i>Taxed As</i>
Amount by which loss did not result in a tax benefit:	
Amount in excess of 1941 net income.....	\$ 50,000
Amount of mortgage.....	200,000
	<hr/>
	250,000 Not taxed
Amount by which loss <i>did</i> result in a tax benefit.....	250,000 Ordinary income
	<hr/>
Original adjusted basis of property.....	500,000
Additional amount recovered over and above portion that resulted in a tax benefit.....	500,000 Gain upon involuntary conversion
	<hr/>
Total market value of recovered property.....	\$1,000,000

As a practical matter the portion of the value of the property recovered in the foregoing example, which is indicated to be subject to tax as a gain upon involuntary conversion (\$500,000), would probably not be taxable at all. Since the proceeds (i.e., the property itself) are reinvested in "property similar or related in service or use" (i.e., the property itself) the gain would not be recognized under the provisions of Section 112 (f) of the Code.

There exist many practical difficulties in determining the amount of taxable income resulting from war loss recoveries. For instance, there is the problem of determining *if* and *when* recovery takes place. What credence can be placed upon the expression of a governmental regime which may or may not be temporary? *Has* recovery taken

place if the political authority of a liberated country indicates that the title reverts in the original owner when, as a matter of fact, the owner is precluded by present-day international restrictions from taking possession? What is the "fair market value" of a recovered property in the light of present-day restrictions on foreign exchange and the dearth of international commerce? The answers to the foregoing questions will undoubtedly be determined in time, and a tolerant attitude on the part of both taxpayers and the Commissioner of Internal Revenue will be an important factor if extended litigation is to be avoided. It is gratifying that the Commissioner has already indicated a reasonable and fair attitude with reference to the determination of war losses as

indicated by the regulations he has issued relative thereto.

*Effect of War Loss Recoveries Upon Basis of Property*

Whether or not a taxpayer owning foreign property which is seized has claimed war losses thereupon, it is possible that upon the recovery of the property its basis may conceivably be changed. Section 127 (d) of the Code, in effect, provides that the basis of recovered property is its fair market value as of the date of recovery reduced by any unrecognized gain upon involuntary conversion which is attributable to such recovery. Obviously if the fair market value of the property recovered (plus previous recoveries) is less than the adjusted basis of the property seized, the new basis of the recovered property is its fair market value.

**Involuntary Liquidation and Subsequent Replacement of Inventories on Last-In, First-Out Basis**

When the last-in, first-out method of pricing inventories was first generally permitted to be used for income tax purposes by the Revenue Act of 1939, it was considered as, and intended to be, in the nature of a relief provision. Its purpose was to give recognition taxwise to an inventory method that was believed would substantially minimize the violent fluctuations of economic activity from year to year. It would thus reduce the likelihood of the

payment of taxes upon income inflated by high inventory prices. Probably the use of the method would have accomplished its purpose if our commercial activity had progressed normally. Unfortunately, the economy accompanying World War II with its inflationary price structure and its critical material shortages resulted in the penalizing of many taxpayers who had previously elected to use the last-in, first-out method of inventory pricing. By reason of the swollen demand for their products for either military or civilian purposes, such taxpayers have been literally forced to eat into their base stocks without being able to replace such stocks. Ordinarily these base stocks are valued at prewar price levels with the result that the cost of goods sold in the year of their enforced liquidation has been abnormally low as compared with the selling prices which have been abnormally high. The taxpayer is thus placed in the position of paying income and excess profits taxes at high rates upon artificial profits.

In order to alleviate this inequity, Congress, in the 1942 Revenue Act provided limited relief by adding Section 22 (d)(6) to the Code. The effect of this provision and the requirements for qualification thereunder are hereinafter discussed.

*Operation of Lifo Relief Provision*

A taxpayer who uses the Lifo inventory pricing method and who by

reason of war conditions is forced to liquidate any portion of his base stock in any taxable year beginning after 1940, and who cannot replace such base stock in that year, is entitled to the use of the provisions of Section 22 (d) (6) of the Code. He may elect in his return for the year in which the involuntary liquidation of the inventory takes place to so avail himself of that provision. Therefore, if and when he replaces the base stock inventory in a subsequent year at prices higher than those at which he carried the base stock, he is entitled to decrease his taxable income for the year of liquidation by the difference between the original inventory cost and the cost of replacement, and he thus receives any tax refund as the result thereof. However, a possibly serious detriment exists in the election to use the benefits of the section. If the subsequent replacement of the base stock takes place at prices *lower* than the original cost of the base stock, the taxpayer is required to *increase* his income for the year of involuntary liquidation and pay additional taxes thereon. An example of the operation of the provision follows:

A taxpayer using the Lifo method has on hand 1,000 units of raw material at 1/1/44, which are carried at a per unit cost of \$1. Because of the heavy wartime demand for his product he is forced to use 800 units of such base stock without being able to replace them. His cost of goods sold is therefore charged with \$800 by reason of the use of these materials. He elects in his 1944

return to avail himself of the relief provision.

In 1945 the taxpayer is able to and does replace the 800 units at \$3 per unit. He is then entitled to increase his costs for 1944 (the year of forced liquidation) by \$1,600, representing the difference between the original cost of the base stock used and the replacement cost thereof. He may obtain a refund for 1944.

If, however, the replacement cost of the 800 units in 1945 is 50 cents per unit, the taxpayer is required to *decrease* his costs for 1944 by \$400 and pay additional taxes upon the increase in income for that year.

#### *Conditions Necessary for Application of Lifo Relief Provision*

In order for a taxpayer on the Lifo inventory basis to avail himself of the provisions of Section 22 (d) (6), the following conditions must be present:

1. The taxpayer must fail to have on hand at the end of the taxable year for which benefits are claimed merchandise of the kind, description, and quantity of that reflected in his opening inventory for such year.
2. He must satisfy the Commissioner that such failure is due wholly to his inability to purchase, manufacture, or otherwise produce and procure delivery of such merchandise during the year of liquidation by reason of war conditions (i.e., material shortages, etc.).
3. His closing inventory for a taxable year ending not more than three years after the end of the war as proclaimed by the President, reflects in whole or in part the goods previously liquidated. (Sec. 27.22 (d)-7, Reg. 111.)

*(Continued on page 22)*

## Depreciation Allowances for Federal Income Tax Purposes\*

BY JOEL D. HARVEY

The Internal Revenue Code provides that—

Section 23. In computing net income there shall be allowed as deductions:

- (1) A reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—
  1. Of property used in the trade or business, or
  2. Of property held for the production of income . . .

This is a broad provision which, if reasonably administered, would be satisfactory and fair to the taxpayers, and there is no question that the Treasury allows total cost less salvage value of depreciable assets to be deducted from income over the whole period of their use. However, in the matter of allocating portions of this total depreciation to annual taxable periods, the Treasury Department is in constant conflict with taxpayers respecting annual depreciation rates for Federal income tax purposes and makes frequent adjustments in those rates.

This situation has been particularly troublesome to small businesses because the uncertainties of

final tax determination make planning for working capital requirements difficult so that investment of venture capital is less attractive. It has also tended to delay modernization of plant and equipment and has absorbed the time of business management which could be put to better use.

Under present practice in arriving at taxable income, the Treasury Department allows deductions for depreciation only to the extent of rates approved by it. In many cases these rates may be changed from year to year. This policy has by no means always resulted in collection of the maximum amount of taxes over a number of years. Many cases can be found where a reduction of depreciation allowances in one year or in a series of years has resulted in greater allowances over a later period, when tax rates were higher. Such a saving, however, cannot be counted on and does not generally make up for the disadvantages of uncertainty, for the taxpayer's difficulties in planning, and for the general nuisance of dealing with tax controversies and adjustments.

In determination of depreciation rates obsolescence is an important factor as well as physical wear and

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\*Statement presented at subcommittee hearings of the Small Business Committee of the U. S. House of Representatives at the Hotel Statler, Boston on May 17, 1945.

tear. In many cases obsolescence is more important. There seems to be little doubt but that the management of a business is in a much better position than the Treasury Department to determine the factor of obsolescence in depreciation rates. Engineers of the Treasury Department may be qualified to pass upon depreciation rates resulting from wear and tear, if the conditions under which equipment will be operated are known. But future maintenance policies, methods of operation, etc. are important factors and estimates as to these can best be made by the managements. In the light of the foregoing, it is suggested that depreciation expense should be allowed for tax purposes in any year at least to the extent that it is recorded on the books of the taxpayer and is in accordance with a reasonable and consistent policy.

Small businesses frequently must operate on a relatively narrow working capital margin. Planning in advance for cash requirements of the business would be simplified, if the present uncertainties as to final determination of tax liabilities are reduced. Under the present situation many businesses have been faced suddenly with substantial additional tax assessments resulting from reduction of depreciation rates claimed by the company in its returns for a prior single year or several years.

The investment of capital in

small business would be made more attractive if there could be assurance that depreciation would be allowed for tax purposes on the basis of management's judgment as to the useful life of depreciable assets, including an allowance for possible obsolescence. Recognition of the proposal frequently made, to take heavier rates of depreciation in the first years following acquisition of new equipment, would be of material assistance in attracting capital investment.

Annual depreciation allowed on an old machine plus the cost of repairs to keep it in running order may often be greater in total than the depreciation which would be allowed on a new machine. Such a situation may discourage investment in new equipment which, if made, might result in lower cost and better production. Assurance of more adequate depreciation rates in the future should be a strong incentive toward replacement of old equipment.

Under the present Treasury Department policies, it is a real hardship, if not an impossible task, for a small business to gather facts and figures regarding depreciable property for the purpose of justifying rates of depreciation to the satisfaction of the Treasury Department. The small business generally does not have large groups of similar equipment on which experience studies can be made for setting

*(Continued on page 22)*



## Some Reminiscences of a Draft Board Chairman

BY HARRY O. LEETE

(*New York Office*)

For a soldier who has gone through battle after battle and then receives an honorable discharge, there are many episodes during his military career about which he may reminisce that serve to interest and entertain the listener who has not had such experiences. I recall hearing many of them when I was a boy. Always there was a certain amount of glamour or romance, but I fancy it is a safe guess that that was because the subject was much easier to reminisce about than the actual participation in warfare.

A Draft Board Member may, when the present war is over, recall humorous incidences which occurred during his Selective Service career, but you may be assured he will never be able to electrify an audience with any glamorous reminiscences. I speak from experience. Since my appointment on October 17, 1940, there have been many times when I wondered whether the principal qualification of a Board Member was that of being able to "take it," not only from registrants, but from the public at large. The service has been hard, without reward of any kind, save that reward which one gets from doing a job to the best of his ability and for a cause in which he believes. There has been no touch of Rotari-

anism in the work—Babbitts would not be attracted; nor would those critics who never do anything except catch the 5:15 train and tell fellow commuters how the universe should be run, find the slightest interest in Selective Service activities.

The Board of which I have the honor of being Chairman is one of 280 in Greater New York, situated in the borough where the famous tree grew. It consists of five members, the other four comprising two managers of banks, an executive of the New York Telephone Company and a retired Police Captain. Each of us has a distinctive personality; there have been times when none of us has seen eye to eye about a particular case and heated discussions have ensued. Despite this, we are one of the few Boards which has the same members who were appointed by the President at the inception of Selective Service, almost five years ago.

Much misapprehension exists among the public as to the function of a Draft Board Chairman. While it is true that all communications from Selective Service Headquarters are addressed to him and after appropriate Board action he answers them, he is in no sense the "boss." He is the servant of the

Board, not the master. He presides at its meetings and at hearings with registrants; formulates ideas for submission and approval by the Board regarding delegation of work, matters of policy and general organization; acts as arbitrator where differences of opinion arise among the members.

One of the first policies we adopted, which has not only served to safeguard our reputations but has saved us from more than one headache, was that, (1) we would not act individually on a case, (2) we would not participate at a hearing of a registrant whom we knew or knew of, (3) we would not interview a registrant at our homes, business locations, nor discuss the case over the telephone.

At the beginning there was considerable organizational work, and in addition a vast amount of detail which could not be delegated to paid employees, such as assigning local draft board numbers to registrants and matching such numbers with those which came out of the "fish bowl" at Washington. The efforts incidental to creating this potential Army necessitated our working five nights a week for the first few months, three nights a week for the ensuing three years, gradually tapering off to two nights a week, and since the summer of 1944 one night a week.

For the first three months, we met in the basement of a public school, a most uninviting spot.

Our present quarters are in an unpretentious store; we have no rugs on the floor, the furniture reminds one of the benches the barefoot boy sat on in school, and the walls are bare except for a bulletin board, some patriotic posters and a couple of calendars.

While we have made no attempt to take a census of the national origins of the registrants, I believe it safe to say that we have every known origin with the exception of Hottentots. Many of them are naturalized citizens and first generation Americans whose formal education has been sadly neglected. We have at times been forced to engage the services of an interpreter. These conditions have made it doubly hard to get the facts and form an opinion on the merits of certain cases. We have had to consider the men one by one, for no two men are alike; each registrant has to be considered separately for his physical fitness, his family's economic status, and ability to spare him from civilian duties.

One of the most irksome tasks has been keeping up with and understanding the volumes of regulations and rulings. They are not written in a manner that "he who runs may read," rather they have been at times conflicting and ambiguous. Another irritating factor has been the change in the age "freeze," e.g.: about a year ago we were instructed not to induct any-

*(Continued on page 18)*

The L. R. B. & M. Journal

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Reconversion and Taxes

For four years American industry has been producing at a pace hitherto undreamt of; the miracle of production during those years, the genius and resourcefulness of American business in providing the tremendous quantities of matériel required for the waging of total war, undoubtedly was a decisive factor in the winning of the war.

Now industry is faced with the

task of reconverting to a peacetime economy, a task which may be more difficult in many respects than that of organizing for war. Industry will require sizable cash resources during the reconversion period for financing new production layouts, purchases of machinery and tools, the accumulation of inventories, and to meet payrolls, taxes, etc. during the interim period before any substantial amount of

income from sales becomes available. Although many companies during the war years created reserves for post-war adjustments, in most instances these reserves were not funded.

The enactment of the Tax Adjustment Act of 1945 should assist materially in meeting this situation. The principal features of this latest piece of tax legislation are discussed in the first article in this issue of the JOURNAL.

The press has recently carried numerous articles quoting Senator George, Chairman of the Senate Finance Committee, Representative Doughton, Chairman of the House Ways and Means Committee, and other Congressional leaders, to the effect that further tax revisions are necessary in furtherance of the reconversion program, and will be considered by Congress at an early date. It is hoped to have a new tax law enacted by December 1, in time for the new tax program to be put into effect on January 1, 1946, particularly with reference to any changes which may be made in the tax withholding provisions. Prominent among the subjects to be considered are the repeal or lowering in the rate of excess profits taxes and some downward adjustment in individual rates, either by changes in the rate schedule or by a flat horizontal percentage reduction.

The revisions in the tax Code

which have been or will be made during 1945 undoubtedly will be helpful in this reconversion period, but they illustrate once again the apparent unwillingness of Congress to face the realities regarding our federal tax structure. Apparently the country is to have two tax laws enacted during 1945, the same as in 1944. The changes may be desirable, but they represent piecemeal legislation, in the form of amendments to the Internal Revenue Code, and not the complete rewriting of the country's basic tax law which is so sorely needed. The Code has become so complex that the average person or business executive finds it virtually impossible to keep abreast of the "rules of the game."

For several years industry has pleaded with Congress to enact a post-war program of taxation which could be put into effect when the war ended, claiming that a stabilized tax program and an understandable law were essential to formulating plans for reconversion and post-war production. To this end a number of tax programs have been prepared and published by authoritative and responsible groups.

The American Institute of Accountants and other professional bodies several years ago urged the appointment of a nonpartisan tax commission to write an understandable revenue law which would express a permanent and consistent

policy of federal taxation. Legislation to that end has been introduced in Congress, but remains "in committee."

Secretary of the Treasury Vinson has stated that modernization of the federal tax structure is the foundation of the whole program for full employment. We hope that his version of "modernization" contemplates this much needed re-writing of the Code in its entirety, and not further patchwork legislation.

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### Quarter Century Club

The September, 1944, issue of the JOURNAL, contained an editorial telling of a dinner at which gold watches were presented to six members of the New York staff, each of whom had been connected with our firm for twenty-five years or longer.

On July 17 last, a similar event took place at the Pelham Country Club. At a dinner attended by most of the partners and staff of the New York office, Colonel Montgomery presented the following men with suitably inscribed gold watches in recognition of their twenty-fifth anniversary with the firm:

Rudolph G. Flachbart  
David Hardie  
George W. Pavelka

On April 25, the original six members of the New York Chapter

of the Club were hosts to the three prospective members at a luncheon at historic Fraunces Tavern.

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### "Big Business"

To judge from the emanations from the anti-trust division of the Department of Justice and from the effusions of New Deal philosophers over a period of years, one would assume that one of the principal aims of so-called "big business" is to keep prices for their products just as high as possible, and that this is a major cause of such economic ills as our country experiences from time to time. Little mention is made of the more or less constant reduction made in the prices for products and services of various kinds in the industrial and utility fields.

A recent advertisement by the General Electric Company brings out in a typical way the bright side of the economic picture. In 1907 the price of 60 watt G-E Mazda Lamps was \$1.75 each. Since then the price has been reduced time and again, so that by 1942 (and today) the price is 10 cents each (plus tax). Further, a diagram in the advertisement shows that, as a result of constant research by the company, between 1923 and 1945 the efficiency of the 60 watt lamp had been increased 56% at the same time that the price had been decreased 75%. "A word to the wise is sufficient."

**Tax Adjustment Act***(Continued from page 5)*

to the taxable year in which the net operating loss or unused excess profits credit arises. For example, if a taxpayer has a net loss for 1945 which is carried back to 1943 and results in an unused excess profits credit for 1943 which is carried back to 1941, the taxpayer may file a claim for refund for 1941 within the period of limitation applicable to 1945.

**CONSOLIDATED RETURNS**

The application of the new provisions regarding extensions for payment, tentative carry-backs and amortization adjustments to companies filing consolidated returns is left to regulations to be prescribed by the Commissioner with the approval of the Secretary of the Treasury.

**Reminiscences of a Draft Board Chairman***(Continued from page 14)*

body over twenty-six years old; at the time of the Battle of Ardennes Forest in December, 1944, the age was stepped up to thirty-four; recently it was "frozen" at age thirty. These constant changes have occasioned much hardship for registrants who have been unable to find new housing facilities and whose scale of living has had to be lowered due to "allotments" being insufficient to care for family needs. Fifty dollars a month may raise the standard of living for a wife in South Carolina but in New York it is impossible to subsist on such a sum. Of course that is the fault of the Congress—not of Selective Service; yet local Draft Boards have the difficult task of coping with these conditions.

From time to time we have heard of casualties of men we have inducted—some whom we saw grow up from children—and you may

surmise what our emotions were upon such occasions.

It has been said that Draft Boards typify "democracy at work with its sleeves rolled up." Speaking for our local Board, I can say without equivocation that we have been unremitting in our efforts to conduct our activities in a manner befitting the democratic way of life to the end of making better Americans out of registrants.

One last word. Our experience has given us the strong conviction that, except for an infinitesimal number, the present generation is to be commended highly for its patriotic zeal. This is the more striking when one considers how many were misled through textbooks, radio-commentators, and in some instances in the public press, to believe that World War I was fought for war profiteers.



## Notes

The following members of the L. R. B. & M. organization have entered the armed services since the publication of the May issue of the JOURNAL:

*Chicago:*

Edward P. Wilmsen

*New York:*

Raymond J. McGinniss

*Philadelphia:*

Anthon J. DiIenno

It is with deep regret that we record the deaths of George H. Everett, of our St. Louis staff, and Frederick B. Stewart, of our Louisville staff.

Mr. Everett suffered a heart attack while working in the office late in the evening of June 19th and died at his home that night. He was only forty years old.

Mr. Stewart also died suddenly of a heart attack on June 19th. He was 55 years of age and, prior to joining our Louisville office in January, 1942, had been associated with several banks in that city. He was a Mason and a Past Grand Master.

Our deepest sympathy goes to the respective families.

Mr. Sweet, as one of the representatives of the American Institute of Accountants serving on the

National Conference of Lawyers and Certified Public Accountants, attended a meeting of that organization held in Washington on May 4.

In April last Mr. Sweet acted as toastmaster at a testimonial dinner given by the American Institute of Accountants and the Massachusetts Society of Certified Public Accountants in honor of Mr. Ira Mosher, President of the National Association of Manufacturers. Mr. Mosher is a certified public accountant, and has been a member of the American Institute and of the Massachusetts Society for more than thirty years.

The American Institute of Accountants has announced the publication in September of a book entitled *Contemporary Accounting*, designed to serve as a refresher course for public accountants, particularly those returning from service in the armed forces. It is interesting to note that the names of four members of our organization appear in the list of 37 contributors of chapters in the book. Mr. W. A. Staub has written on "Intangible Assets," Mr. Sinclair on "Budgets and Budgetary Control," Mr. Richardson on "Changes in Taxation of Corporations" and Mr. R. G. Ankers, of our New York staff, on the "Fair Labor Standards Act."

The Call and Program of the 48th Annual Meeting of the Pennsylvania Institute of C. P. A.'s, which was held at Pittsburgh on June 18th, indicated reports by Mr. Ross as Chairman of the Committee of Institute Publications and Associate Editors and of the Historical Committee, and by Mr. Richardson as Chairman of the Philadelphia Chapter. Mr. Pugh, Mr. Fischer, Mr. Marsh, of our partners, and Mr. Frederick M. McHugh, of our Pittsburgh staff, were members of the committee on arrangements for the meeting.

Mr. Russell has spoken on three occasions in recent months on the subject "War Contract Terminations"; in Louisville and Indianapolis before the local chapters of the National Association of Cost Accountants and in Detroit before the Walsh Institute of Accounting Alumni.

Mr. Marsh addressed the North-western chapter of the Pennsylvania Institute of C. P. A.'s at a meeting in Oil City on April 24th, his subject being "Annual Reports to Stockholders."

Mr. Harvey was elected president of the Massachusetts Society of Certified Public Accountants for one year beginning in May, 1945, after having served one year as vice-president and previously as secretary.

On May 17, 1945, Mr. Harvey presented a statement on "Depreciation Allowances for Federal Income Tax Purposes," at subcommittee hearings of the Small Business Committee of the U. S. House of Representatives at the Hotel Statler, Boston. The statement appears in another section of this issue of the JOURNAL.

Mr. Drabenstadt was re-elected Chairman of the Pennsylvania State Board of Examiners on May 11th.

Mr. Raymond G. Ankers, of our New York staff, attended a joint meeting in Chicago on June 22nd and 23rd of the American Institute's Committee on Education and a special committee of the American Accounting Association. Mr. Ankers led the discussion of staff training methods, and also was appointed as chairman of a special committee to study the obtaining of auditing materials which could be used by teachers of classes in auditing.

Mr. Hunter is serving as chairman of the Massachusetts Society of Certified Public Accountants' Committee on Cooperation with Veterans.

Mr. Halloran has been elected a director of The Kentucky Society of Certified Public Accountants, and has also been elected secretary and treasurer for the ensuing year.

Messrs. Arthur L. Gavin, Clarence W. Hill, Jr. and Rupert D. McCurdy, of our Boston staff, have been admitted as associate members of the Massachusetts Society of Certified Public Accountants.

Mr. John T. Harvey and Mr. Donald S. Skinger, of our Chicago staff, passed the latest Illinois C. P. A. examination.

Mr. Harry F. Spengler and Mr. R. L. Williams, of our Detroit staff, have been awarded their Michigan C. P. A. certificates.

The *May, 1945*, issue of the L. R. B. & M. JOURNAL contained a letter from Lieutenant (j.g.) Edward M. Zolla, Jr., USNR, of our Chicago staff, concerning the remarkable performance of the battleship *Washington* on which he was serving. The following Associated Press dispatch from Bremerton, Wash., which appeared in the *New York Sun*, may be regarded as in the nature of a supplement to Lieutenant Zolla's letter report:

A great, gray hunk of fighting metal, a ship which has poured fire upon the enemy from Guadalcanal to Okinawa without losing a man in battle—that's the *Washington*.

The U. S. S. *Washington*, a battleship which has steamed 277,084 miles since December 7, 1941, today was home in the State for which she was named, in a dry dock at the Puget Sound Navy Yard. The big job done, the *Washington* has come home for overhaul.

The Navy told some of her story today. Her first job was as a reinforcement for the British fleet, escorting convoys to Murmansk. She was moved to the Pacific when the Japanese threat became dangerous, and was the first battleship to sink a Nipponese battleship in surface action. That, said the Navy, happened off Savo Island on the Night of November 14-15, 1942.

"At Iwo Jima she unlimbered her guns from 1,500 yards off shore and, in one of the greatest precision shooting performances of the war, wiped out Japanese strongholds only 300 yards ahead of our troops," said the Navy's account.

"At Okinawa the *Washington* compiled a record for continuous operation that may be the all-time high for battleships in this or any war. She pulverized the beach, accompanied the fast carrier task force as they raided the Japanese homeland, provided support fire for ground troops and anti-aircraft fire for the task forces through seventy-nine days."

The *Washington* was the "newest, fastest and finest battleship in the fleet" when she was launched in June, 1940, at the Philadelphia Navy Yard. Her skipper is Capt. F. X. McInerney, resident of South Pasadena, Cal.

Perhaps the most wonderful feature of all the long and effective service rendered by the *Washington* is the record of "from Guadalcanal to Okinawa without losing a man in battle."

## Tax Effects of V-Day

(Continued from page 10)

### *Method of Electing to Use Lifo Relief Provisions*

A taxpayer wishing to avail himself of the provisions of Section 22 (d) (6) must so elect in his income tax return for the year in which liquidation or partial liquidation of the inventory takes place. Such election is binding upon him for that year, although not for any subsequent year in which further liquidation may take place. The election is made by attaching to the return a statement containing the following information:

1. The wish of the taxpayer to invoke the involuntary liquidation and replacement provisions.
2. A detailed list or other identifying description of the items of merchandise claimed to have been subjected to involuntary liquidation, and the extent to which replacement is intended.
3. The circumstances relied upon as rendering the taxpayer unable to maintain throughout the taxable year a normal inventory of the items involved.
4. Detailed proof of such circumstances to the extent that they may not be the subject matter of common knowledge.
5. A full description of what efforts were

made on the part of the taxpayer to effect replacement during the taxable year and the result of such efforts.

### **Deductibility of Corporate Contributions to Certain Charities Operating Overseas**

Except for the retention of the five-per-cent-of-net-income limitation, corporations are otherwise allowed to deduct in time of war the same contributions as individuals. This has enabled corporations to make contributions during wartime to corporations, trusts, chests, funds, and foundations engaged in raising funds to alleviate suffering and want caused by the war in foreign countries. However, Code Section 23 (q) provides, in effect, that contributions to such organizations within taxable years beginning after the cessation of hostilities as proclaimed by the President will not be deductible by corporations for the reason that the qualification that such contributions must then be used within the United States or any of its possessions will again apply.

## **Depreciation Allowance for Federal Income Taxes**

(Continued from page 12)

depreciation rates. Rates based alone on experience with small groups of assets or on a short period of time cannot be relied upon with safety. Business judgment must

enter into the rate determination to a large extent.

Small businesses have been particularly affected by the administration of the tax laws, which too

frequently appears to be activated by the idea of getting as much in taxes as possible in each individual year. If it is not possible to improve the administration, then the best method of relief would appear to be change in the statute requiring acceptance, for tax purposes, of any allowance for depreciation taken on the books which accords with sound accounting principles. Adoption of this idea for other

factors of income and expense as well as depreciation should have strong support. Many difficulties of administration of the tax law would be alleviated, if the net income shown by the company books were accepted as the basis of taxes except for cases substantially at variance with sound accounting principles or for fraudulent or grossly negligent returns.

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### Report From Manila

From time to time we have printed in the *JOURNAL* letters from staff members relating their experiences in foreign lands as members of the armed forces, enabling those of us who have remained on the "home front" to gain some insight into the conditions under which our men have lived and fought during the last several years. The following paragraphs taken from a letter from Staff Sergeant Norman A. Bolz, who was a member of our Detroit staff prior to his induction into the army, related some of his experiences and observations while in the Philippines:

The last you heard from me I was still down in New Guinea, specifically in Hollandia, where quite a heated battle took place in June of last year. With our onward move there of course was the work that usually accompanies such a move. We are a very small unit, but being a Replacement Depot we had to carry supplies and equipment for several thousand men with us.

Our first days here in the Philippines presented a pretty gloomy outlook for us. We encamped temporarily in another depot until such time as we could build our own area. The area allocated to us was nothing more than a bunch of flooded rice paddies. Because the equipment had to be unloaded and that was the only place they would let us put it, we worked day and night for several days in knee deep mud unloading trucks. There was certainly a lot of ruined supplies in that field—the waste was actually appalling.

Manila is in just as bad a condition as pictured by the newsreels that you have undoubtedly seen. The Filipinos have apparently made little or no effort at reconstruction, and the army has only done what was necessary so as not to interfere with military operations. Of course the walled city is completely destroyed, but practically all of the buildings and homes have been damaged by bombing, gunfire, or just plain burning.

I have found the Filipino people very interesting. Most of them speak English quite well, except when it is to their advantage not to know it. We have met and talked to many of the better educated ones,

particularly trying to get to talk to the schoolteachers as they were actually permitted to live almost normal lives under the Japanese and can give a more impartial view than the people who were forced up into the hills.

The people here could be described as rather "peso-happy." Prices are sky high and a soldier's pay doesn't go very far. The Filipinos seem to do pretty well, but yet of course, they have to pay tremendous prices for the things they want. Cigarettes, for example, on the black market sell for ten pesos (one peso equals fifty cents).

Where we were first located fruit seemed plentiful; bananas, pineapple, mangoes, and the like were in quantity, but expensive. Nevertheless we from Hollandia, who hadn't had any fresh fruit at all for ten months, were pretty glad to pay any amount to get it. However, now that we have moved to our regular location north of Manila there doesn't seem to be much fruit available.

The heading of this letter may be a bit misleading inasmuch as we are not actually in Manila. But it is the nearest city of any note and we are but a few miles from there. We are located on a large hill, perhaps I should say mountain. The one side of our camp goes down almost sheerly into a long and very beautiful valley. A wide river flows back and forth along the valley floor and in the distance we can see the buildings of quite a fair sized town. The whole valley is so very far below and yet so clear that it resembles an aircraft view. The entire valley is divided into the typical rice paddies of the Philippines, most of which are constantly in a state of flood. During the day you can faintly see the people with their water buffalo working down in the fields. The procedure is to plant one plot and then

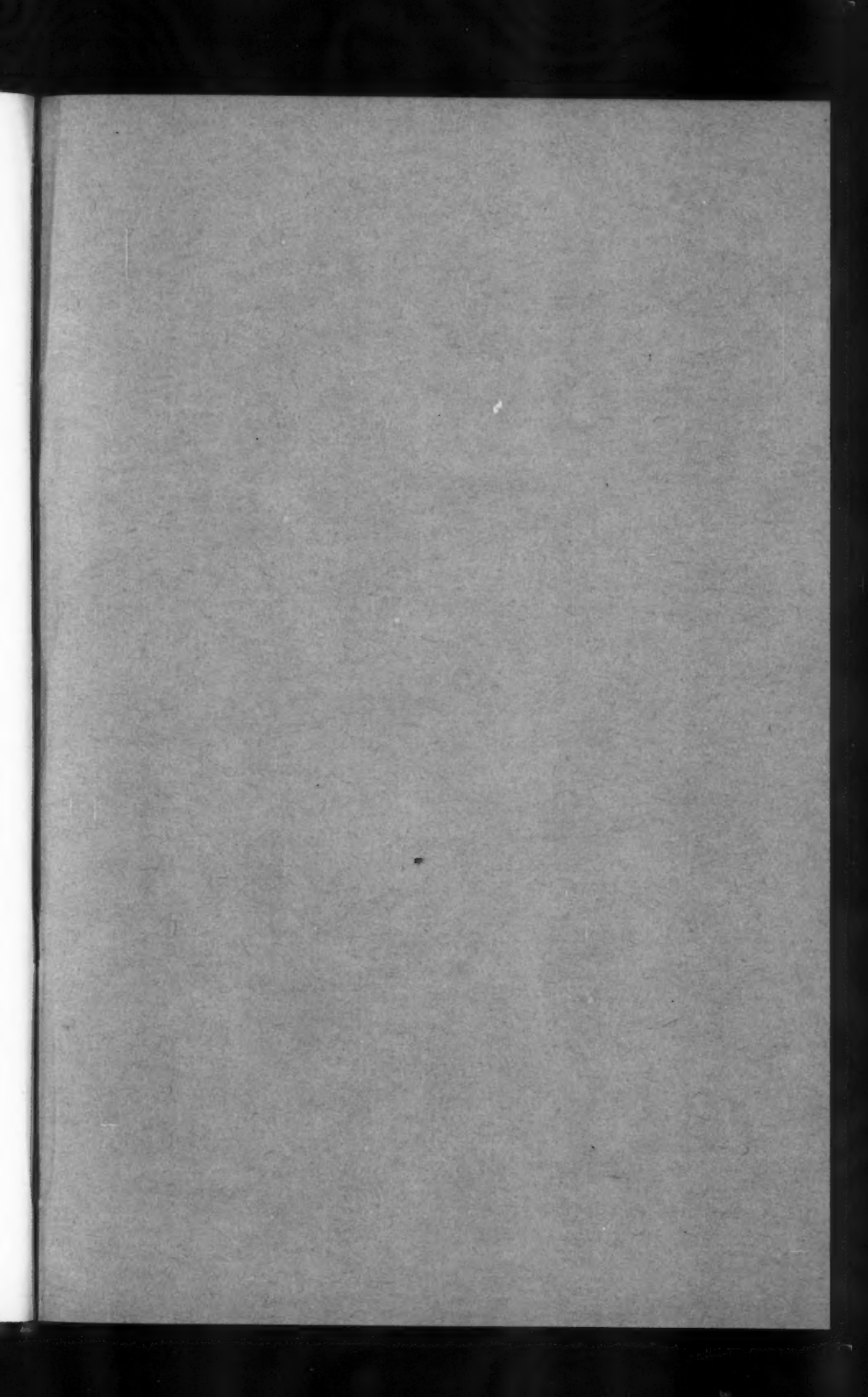
as that grows green and bushy they transplant it all by hand into the other plots, working almost always in mud up to their knees. It is quite an interesting procedure to watch, either from a distance or from close up.

Everything has been a great deal more satisfactory here than in New Guinea. For one thing the food situation is excellent. I would imagine that we are overly fortunate in being in this type of an outfit where we always overdraw on food to handle any number of men that might come in. As a matter of fact we haven't had a bit of bully beef since we arrived here, and we hardly missed a day back in Hollandia. Chicken seems to be one of the easiest things to get and we have been eating that on an average of two times a week. We still don't get much fresh food from army chow as far as vegetables and fruit goes, however.

Our laundry is all done by Filipinos. There is some sort of a GI laundry arrangement, but most of us find it cheaper, quicker, and better to have it done by a Filipino girl. Our Pauline is sort of on the plump side, but she does an excellent job on my laundry as well as doing some very necessary mending for me, so I am quite satisfied. They come right up to the tents to pick up the clothes and deliver them. What still strikes us as peculiar is to see them hoist a barracks bag, that any GI would quail before, up on their head, adjust it a bit, and trudge off as if they were just out for a stroll.

It doesn't rain as often in the "Philippines" as in New Guinea, but when it does rain I think it rains a lot harder. The climate is a lot drier and as a result seems quite a bit warmer than I have been used to even though we were closer to the equator before.





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